1812

1946

Economic Conditions
Governmental Finance
United States Securities

New York, October, 1946

General Business Conditions

THE decline in stock prices has overshadowed other business developments during September. There is always dispute as to the precise cause of a break in the stock market, but whatever the cause any serious weakness is an influence for conservatism. The market is a kind of poll of public opinion as to the business prospect, and one in which the voters back their votes with their money. It has a reputation of forecasting ability, derived from the belief that collective judgment is a more trustworthy guide to the future than individual opinion. To be sure, its appraisals of the outlook have not always been infallible, and they are subject to reversal at any time. A drop in the market may be only a correction of an earlier over-optimistic appraisal, looking more to the past than to the future.

Nevertheless, the break indicates that temporarily at least there is a preponderance of unfavorable or less favorable estimates of the situation. Pessimists feel that their views are confirmed and optimists wonder what they are overlooking. Both give more attention to the uncertainties which are always present. This attitude may affect other business decisions, both as to current buying and programs for capital expenditure.

Apart from the psychological influences, stock market changes have direct effects on business. New financing through the sale of stock issues to the public is hampered when prices of outstanding stocks decline, which may cause some curtailment of expansion programs. Luxury trades are affected because people are apt to buy luxuries out of capital gains, and capital gains disappear. It is a misapprehension, however, to think that the real wealth of the country is reduced by the repricing which takes place in the market. Productive facilities are not impaired and the money losses and gains of individuals are at each other's expense. What occurs is a redistribution of the ownership of property in which some take losses, on paper or actually, and others gain by buying more cheaply. The major question is not what damage the decline has caused, but whether a drop in business is portended, which would not only depress stocks further but cause real losses through declines in production, employment and trade.

Confidence and Apprehension Mixed

Throughout this year there has been a mixture of confidence and apprehension in analyses of the business situation, for reasons to which these Letters have frequently alluded. The optimistic analysis has stressed the huge and urgent demand and the resources possessed by buyers to satisfy their needs. The apprehensive view has conceded the needs, but feared that the combination of sharp wage increases, strikes and low labor efficiency would hamper production and force costs and prices of goods beyond the reach of too many buyers; and that despite unsatisfied wants sales would slacken, profits would be squeezed, and expansion be checked — all this against a background of discomfort about the international situation.

Actually, many people combined both opinions, holding that accumulated demand would absorb cost and price increases and keep business at top speed for some indefinite time; but that as the most urgent needs were filled it would be found that costs and prices were out of balance, that the situation could not support itself under normal demand conditions, and that recession and depression would follow. In short, they believed that the country was on the "boom and bust" road, without having much idea when the passage from boom to bust would occur.

Even during the great strikes earlier in the year, the view prevailed that production would get going in the second half-year, and that earnings would be satisfactory. It is now seen that in important cases these expectations are not being realized. The automobile industry in particular, and consumers' durable goods in general, including residential building, have failed to reach the operating rates scheduled

for this time. The trouble is principally the lack of a smooth flow of materials and parts, which results in shortages and bottlenecks that limit output. Secondarily, it is low efficiency of labor. Manufacturers in these lines are not optimistic as to when their difficulties will end, and they are reducing their projections as to future output accordingly. With production hampered and unit costs high, earnings are below expectations. The market naturally adjusts itself.

In other cases, as in textiles, production has climbed as the year has gone on and has reached phenomenally high levels. Even in these cases, the market has seemed to feel that an adjustment is coming. The bearish view is that the huge output is filling pipelines and in due course will satisfy shortages, and that recession will follow. The break-even point of the industries generally is high because labor costs per unit of product are high. A decline in sales therefore would affect earnings quickly.

Underlying all these apprehensions is a feeling of distrust and disturbance because people are not pulling together well enough to get the productive organization working at full capacity and to keep it going that way. Employers are paying the highest wages in history but most of them worry less about wage scales than they do about the willingness of their labor to do an efficient day's work. In public statements labor leaders join with employers in emphasizing the need of production to raise living standards, but along with this goes emphasis on higher money wages, on shorter hours, on payments for longer vacations and other non-productive time. Union rivalries, organizational and jurisdictional disputes, and petty strikes over petty causes create friction. A record-breaking industrial employment fails to produce a commensurate output, measured by past standards.

Instead of relying upon work and co-operation to improve economic conditions, people have turned increasingly to the Federal Government, but government efforts to help have been in many cases not only abortive but harmful. In the effort to prevent runaway prices, ceilings are maintained at points where they suppress production and create bottlenecks blocking other production. In the effort — now seen to have been based on wrong premises — to avoid deflation and give an incentive to labor, government contributed to wage-price inflation. In the effort to cushion unemployment, it put subsidies on not working.

The feeling has gained ground that these difficulties are basic, and that a sound and lasting prosperity is unattainable until somehow these conditions change and all groups of the population accept the truism that economic progress is achieved only through work and co-operation.

The Strong Points

The strong points in the business outlook are obvious. Except in relatively few lines, demand for goods is active and unsatisfied; most manufacturers can sell everything they can produce and see a market ahead that cannot be filled for months, in some cases for years. The need for residential building can be projected far into the future. Automobile production has not yet caught up with the current rate of scrapping, so that the restoration of the deficit in the nation's stock of automobiles created since 1941, has not yet begun. In other consumers' durable goods and in most non-durables urgent demands are far from satisfied, and people have income, savings and credit resources to buy them. The whole world wants American goods and most of our important customers can pay for them, either through dollars and gold accumulated during the war or through credits extended since. It is significant that in most cases the misgivings of manufacturers have to do not with uncertainty as to demand, but with the difficulty of lifting production.

Demand is not fixed and unchangeable, but varies with purchasing power, prices and psychological factors. Demand may slacken, but in automobiles and construction, and other things as well, it can slacken considerably and still leave a market for all that can be produced. Applications for construction permits far exceed what the Civilian Production Administration will allow. To the extent that demand exceeds possible supply, an abatement helps rather than hurts. Many of the difficulties of recent months — the bottlenecks and black markets — have resulted from the effort to get more out of the productive organization than it could yield at the moment, and many experienced observers have urged people to defer buying or building, and so ease the pressure on the markets, as part of the battle against inflation.

The credit situation — discussed in more detail in a subsequent article — has a great deal to do with the fluctuations of business, and the analogy which some people draw between the current economic situation and that in 1920 falls down chiefly in the credit area. Then credit was employed excessively, in carrying distended inventories and in financing commodity speculation over the world. Banking resources were strained to the point where the Federal Reserve System had to adopt restrictive policies. Credit is immensely expanded today, but it is credit based chiefly on govern-

ment debt, there will be no forced or disorderly liquidation, the reserve position is not strained, and no one expects restrictive policies comparable to those of 1920 to be established. Private debt is relatively small and consumer credit may be expected to expand further before any contraction comes into sight.

The Commodity Price Outlook

Finally there are good reasons for thinking that the commodity price level is in no way as vulnerable as it was in 1920, 1929 or 1937. To this statement there are of course exceptions. They are partly in exorbitant black market prices, as for certain building materials. Some farm products look high, at least if next year's crops get off to a good start. On the other hand, certain important basic commodities which are peculiarly sensitive to business fluctuations are cheaper in this country than anywhere else in the world. These include the non-ferrous metals, hides, and domestic wool. Our production of these commodities is inadequate for our needs; they are held below world prices only by government controls and subsidies, and they can hardly be considered vulnerable unless world markets decline so much as not only to lose their present premiums but to bring in foreign supplies over our tariffs. The premiums are a cushion insulating domestic markets from depression abroad.

Moreover, the Federal Government is committed to maintain floors under most farm prices, through loans on the commodities, for two full crop years after the official end of the war. These floors in some cases are close to existing market quotations, in others considerably below.

Underneath the price structure generally is the supporting influence of the money supply — currency plus bank deposits. The money supply has increased 2½ times since the outbreak of the war, and it is not subject to much contraction except in the improbable event that the banking system's holdings of government securities are substantially reduced. This phenomenon of an essentially non-contractible money supply is a new one in this country, and we do not yet know all that it may signify as to post-war prices and economic conditions.

The Inventory Situation

There is much comment on the inventory situation and most of it leads to a neutral conclusion. Inventories have been increasing, but so have sales and prices. The evidence of Department of Commerce figures is that both in dollar and physical terms inventories are still low, by pre-war standards, in relation to production and trade. Scarcities are holding back production in building, automobiles and many other industries.

On the other hand, stocks which appear inadequate when business is booming quickly become excessive if business falls off, and inventories become unbalanced when procurement is difficult, as at present, and bottlenecks prevent the steady flow of goods. Department stores' outstanding orders particularly are large, and if stores are left with inferior or high-priced goods which people will no longer want as scarcities disappear, they will have an inventory problem in those goods. An important share of merchandise production since V-J day naturally has moved into inventory. It had to do so because pipelines were empty and trade could not go on until they were filled. When they are filled, however, the production that filled them will no longer be needed for that purpose. All current output will be available for consumption.

The emphasis in this matter belongs on the sales outlook. It is miscalculations as to sales which make inventories turn out burdensome.

Weaknesses in Cost and Price Relations

The major weaknesses in the situation have to do with cost and price relationships. It is characteristic of inflationary movements that prices of all products and incomes of all groups of population do not move up together, but unevenly. Those whose incomes lag lose purchasing power for the products of those whose prices are pushed up most, and this disparity weakens demand. It is not sufficient to argue that demand will be high because incomes are high, for demand and incomes are interrelated. If demand weakens because some groups cannot buy, production will fall off, payrolls drop, and incomes of other groups will decline. The essential factor is that prices and incomes of various groups shall be in balance so that they can trade with each other. Excessive costs and unbalanced prices have brought on recessions in the past when there were undeniably needs for housing, automobiles and other goods to be filled.

The imbalance now most to be feared is that created by the rise in the wages of organized labor above what its productivity would support. The effect is to raise industrial costs and prices above the buying power of less favored groups, including those living on relatively fixed incomes. When organized labor, which constitutes but one-fourth of the working population, puts a price on its services which places its product beyond the reach of purchasers it is pricing itself out of the market. Unless the situation is corrected it will have to give up in unemployment what it has nominally gained through an increase in wage rates. This is but another way of saying that correction of an unbalanced wage cost and price situation may require recession or depression, if it is not made through increasing productivity.

In programs of industrial expansion particularly, high costs have a double-edged effect. Industries back away from excessive costs of construction and equipment because high-cost plants mean high depreciation and carrying charges, and hence high-cost products. Excessive operating costs weaken the incentive to expansion because the manufacturer knows — irrespective of what he can sell during the boom — that eventually the resulting prices will narrow his market. For both reasons, corporations in recent months have shown a disposition to pare down and defer programs of capital expenditures. The decision of General Motors and Ford not to go through at present with their plans for new light-weight, low-priced cars is an instance.

It will bear repeating that the economic situation may benefit, both in the short and long run, from postponement of the less urgent construction projects and other types of expenditure in areas where all demands cannot now be supplied. The effect of pressing these demands beyond the power of the market to satisfy them is to create congestion and force up costs and prices — black market or otherwise — at the expense of stability; while if people will take their turn, and not ask the economic organization for more than it can produce, they will gain through more orderly operations, fewer bottlenecks and less waste. The situation will be easier for those who have to go ahead now, and others may reasonably hope for better work at lower costs by waiting.

The Missing Element

It is highly significant that most commentators, and particularly those whose confidence in the outlook is diminishing, are preoccupied with wage rates, labor troubles and inefficiency, and similar factors. Evidently their worries are not about potential demand, but rather that the demand will not be activated and supplied. They are not forecasting recession on such familiar grounds as that shortages have been made up, or that credit has to be liquidated, or that needs for capital expenditure have run out, or that markets are swollen with speculation.

If the heart of the outlook is in labor costs and productivity, as so many believe, the encouraging aspect is that it is within the power of people to improve the situation. Output per man-hour of the industries which have been struggling through the reconversion period will be expected to gain if the flow of parts and materials can be speeded up by attacks on the bottlenecks, and there is some evidence that it is on the rise now. Over and above that, the prospect depends upon the individual will to work and upon cooperation to maintain stability. If all put emphasis on production, and price their work, their goods and services with more concern for the general long-run welfare than for all they can get out of the situation at the moment, the missing element necessary for a long prosperity will be restored. There is a maxim that "hard times make hard work". Some people are amending this to read that "*only* hard times make hard work", and predicting depression accordingly. The objective of all should be to prove them wrong.

It is fortunate that these questions are brought sharply into public notice by the stock market decline at a time when there are such powerful supporting elements, in the nature of demands both at home and abroad, beneath the business structure. Naturally the decline inspires conservatism. If conservatism helps keep the boom within bounds and takes off the excesses that have developed it will be all to the good. The situation can stand some weakening of demand. It can stand a fall in black market prices and others that have been inflated beyond reason. It can stand the kind of recession that might lead to better quality goods and services. Historically, of course, recessions from inflationary conditions have not stopped at precisely the right point where excesses are corrected without any particular unemployment, losses or distress. On the other hand, the present situation is clearly unique in the urgency of unsatisfied demands, the size of accumulated financial assets, and the strength of the credit structure. The real question is whether we as a people can discipline ourselves and pull together.

Stock Market Prices and Credit

In any survey of general conditions prompted by the stock market decline, one question is the extent to which people have got themselves sewed up in debt. For, while credit is a highly useful facility when properly employed, too much credit (debt) can be a serious weakness, greatly intensifying and prolonging periods of liquidation. One of the favorable features of the present situation is that the bull market has been financed to such a large extent by cash and that secured loans have been so low for a period of active speculation.

It has been a good many years, in fact, since the stock market has been seriously vulnerable to forced selling precipitated by declines in stock prices themselves and calling of loans. Cash trading on the stock exchange was a common practice for many investors even prior to the war. For trading after January 21, 1946 the Board of Governors of the Federal Reserve System, under the Securities Exchange Act of 1934, set margin requirements for listed stocks at 100 per cent. The Board had in July of last year raised the requirement from 50 to 75 per cent.

The 100 per cent margin requirement was designed to curb the practice of buying stocks with borrowed money by forcing buyers of shares listed on national securities exchanges to pay for them in full. Much has been written and said to the effect that 100 per cent margins create thin markets for securities, and it is obvious that they limit the buying power that investors and speculators can put into the market when prices, after declines, look cheap. On the other hand, the rule of cash on the barrelhead undoubtedly shut off some credit buying on the rise earlier in the year and thereby helped to avoid forced liquidation later.

The 100 per cent margin rule, however, has by no means eliminated borrowing against securities. Bank loans for business as well as for miscellaneous purposes often have the added protection of security collateral. Moreover, these are specific exemptions from the margin rule; notably, banks may lend on bond collateral without restriction.

While it is not possible to determine precisely the amount of credit involved in borrowings ostensibly for other purposes, but actually for the purpose of purchasing or carrying listed stocks, such amount can hardly be large enough to alter significantly the general picture as shown in the reported loans on securities.

Security Loans Chiefly Against Governments

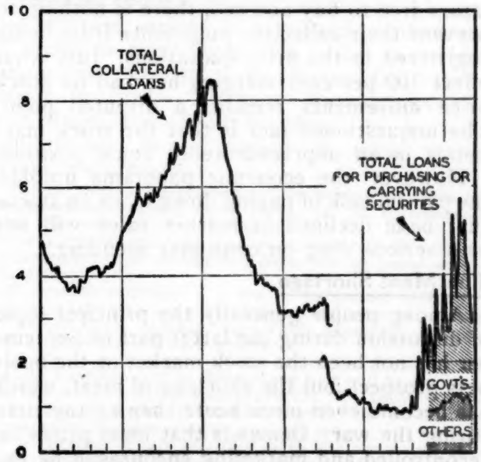
The authorized exemptions together with undisturbed old margin accounts, explain the $2.9 billion loans "for the purpose of purchasing or carrying" securities shown on the latest statement of the weekly reporting member banks in leading cities. These loans reached a peak of nearly $6 billion in December 1945, following the close of the Victory Loan drive, and have since been declining. No less than two-thirds of the present total consists of loans to carry U. S. Government obligations; only one-third, or a little under 1 billion, is for carrying other securities, including not only stocks but also corporate and municipal bonds.

Loans for purchasing or carrying stocks in "old accounts" (stocks held on margin prior to January 21) have been whittled down as holders have sold shares held in these accounts, and for the accounts that have not been disturbed the abundant margin protection already provided in January was widened in the subsequent rising market.

Among loans on securities are those to carry new issues in process of distribution. While there was a substantial volume of new underwriting in process at the time of the stock market decline, the appearance of market indigestion during the summer had slowed the rate of new security offerings, and underwriting margins plus profits made earlier in the year provided cushions for absorbing losses.

In addition, capital in the investment banking business has been increased substantially in recent years and at the same time risks in security flotations have been more widely distributed than ever before. For example, on the $38 million offering of Cincinnati Gas and Electric common stock on September 11 the risk was spread among 228 underwriters, no one of whom was committed for more than 3⅛ per cent of the total. Ten years ago an issue of this size would have been handled by perhaps no more than a fifth this number of underwriters, and the distribution of risks then was already much more widely spread than in the '20s.

The accompanying chart shows the dominance of borrowings on U. S. Government obligations in the security loan picture of recent years, the peaks and valleys generated by the successive war loan drives, and the modest volume of loans for purchasing or carrying securities other than governments. The division of loans against U. S. Governments and other securities is not available prior to 1944; and before 1937, when the "purpose" distinction was first made in the reports collected from the banks, all collateral loans were lumped together. Inasmuch as loans on governments were a relatively small factor in the whole interwar period, and the bulk of security loans made in the '20s was on corporate stocks, the magnitude of the change is apparent.



Security Loans of the Weekly Reporting Member Banks in Leading Cities.

(Upper section of shaded area represents loans against governments, lower section loans against other securities).

Borrowings of Stock Exchange Members

Figures reported by members of the New York Exchange which carry margin accounts tell the same general story. Customers' indebtedness to brokers, partly on the security of

government obligations, has been declining steadily since the 100 per cent margin regulation was put into effect. The total for August 31 was down to $723 million, or practically the lowest levels reached in 1932 and 1933 after the precipitous decline from the 1929 peak. Borrowings, from all sources, by members carrying margin accounts came to only $377 million of which a part was secured by government obligations. At the same time, customers had built up free credit balances with brokers of $647 million, available for security purchases.

It is significant also to note the low proportion of borrowings by members of the New York Stock Exchange to the total value of stocks listed on the exchange. On August 31, just before the September break in stock prices, listed shares were worth $74,350,000,000. Against this amount, total member borrowings of $509 million amounted to only 68/100 of one per cent. From January 1926 — when such ratios were first compiled — up to the stock price collapse of October 1929, this proportion ran between 8 and 10 per cent. Since the depression low of 1.18 per cent at the end of July 1932, the ratio at no time exceeded 3.14 per cent (June 1934). The 0.68 per cent figure for August 31, 1946 is the lowest ever recorded.

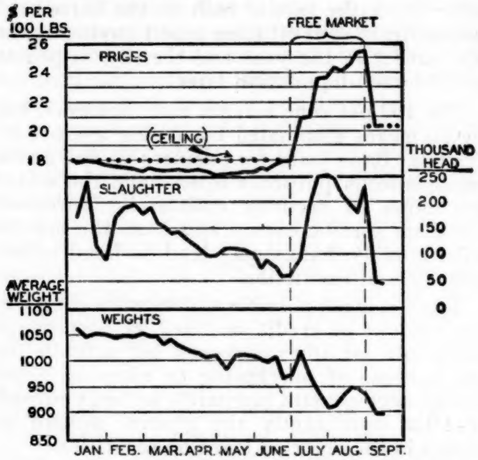
That 100 per cent margin requirements and absence of credit support for stock holdings do not eradicate wide swings in stock prices is abundantly clear. With investors and speculators free to buy and sell, there is nothing to prevent their collective judgments from being registered in the price quotations. Just what effect 100 per cent margins has had on stock price movements remains a disputed point. The unquestioned fact is that the stock market is in an unprecedentedly liquid position.

However the economic panorama unfolds, the painful task of paying down loans on stocks that have declined in market value will **not** be a serious drag on consumer spending.

The Meat Shortage

Among people generally the principal topic of discussion during the latter part of September has not been the stock market or the business prospect, but the shortage of meat, which has become even more acute than at any time during the war. Demands that meat prices be decontrolled and marketing encouraged by the free operation of supply and demand have descended on Washington from consumer groups, municipal and public health officials, union leaders, and also from politicians who realize that public dissatisfaction may find expression at the polls. President Truman took cognizance of the complaints, but apparently has blocked any action by pronouncing for retention of the controls, on the theory that the shortage is temporary and that if people will be patient and see it through, the situation will cure itself in time.

The history of cattle prices and cattle marketing during the past summer is an interesting and revealing one, reflecting as it does the disorder created by government intervention and uncertainty over price control. The accompanying chart showing prices, slaughter and average weights of cattle illustrates well what has happened.



Prices of Choice Cattle, Weekly Slaughter at 32 Markets, and Average Slaughter Weights.

As the time for the expiration of the Price Control Law drew near, cattle growers naturally curtailed their marketings in anticipation of higher prices if ceilings were removed after June 30. This withholding is reflected on the chart by the drop in cattle slaughter at the 32 principal markets from the winter peak down to a new low in June. In the same period, the average weight of cattle slaughtered began to drop, reflecting tightening of feed supplies and the narrowing of feeding margins as price ceilings on grains were raised to divert more into human consumption. As soon as the Price Control Law expired and cattle prices shot swiftly upward, as also shown on the chart, cattle that had been held back for higher prices were marketed. This is shown on the chart by the sharp upturn in the slaughter line during July and August. For a short time cattle weights also rose. But when it became probable, a little later on, that price ceilings would be reimposed, underweight cattle were emptied out of the feed lots and average weights dropped again very sharply.

The wholesale liquidation of these underweight cattle, which should have been coming to market now at heavier weights, represents an irreparable loss of meat to consumers. Having marketed the fed cattle held back earlier in the year, as well as the underfed cattle that should not have been slaughtered, a

situation bordering on a vacuum has been created, and the present extremely low slaughter is the result. As the chart shows, cattle slaughter now has dropped to even lower levels than in June.

Another factor which is keeping slaughter low is that cattle which brought as high as $30 per 100 lbs. during the free market are now ceilinged in the legitimate market at $20.25. After an arbitrarily enforced drop of this magnitude cattle producers are not likely to hurry their animals from the ranges to slaughter.

The abrupt up and down swings depicted by the chart provide another demonstration, this time in terms of lack of meat on the American dinner table, of the disorder and confusion which is injected into the economic system by arbitrary government interference with the price mechanism. The efforts of buyers and sellers to protect themselves in this instance have resulted first in glut, then in scarcity. Because of the lack of natural and free markets, the American people are being forced to go without meat at a time when livestock numbers are close to all-time record levels.

Favorable Outlook for 1947

Looking further ahead, the situation is more hopeful, since this year's record corn and other feed grain crops promise more meat, dairy and poultry products as time goes on. The total feed grain supply in relation to animals to be fed is the largest ever known, and there already are signs that feeding will be intensified and consequently that marketing weights later on will increase. In this connection, the realistic action of Secretary Anderson in raising ceiling prices on both cattle and hogs, to provide incentive to turn the large grain supplies into meat, is already yielding benefits. One of the features of the September livestock market was the very strong demand for stocker and feeder cattle and the high prices which feeders were willing to pay. Considering the extremely low level of cattle receipts all during the month, the volume of stocker and feeder sales, while numerically smaller than last year, represented an unusually high proportion of the offerings. The longer these cattle are fed, the greater will be the eventual supply of beef for consumers, but it will take time to restock the feed lots and get feeding going again in normal volume.

Still another hopeful sign is the indication that the easing in feed supplies is starting an increase in poultry production. During August, hatchings of baby chicks were only a third of last year, culminating a steady decline since the beginning of the year, with production for the eight months 25 per cent below the same period of 1945. However, higher poultry prices (ceilings on poultry have been removed) and lower feed prices combined to bring about an almost over-night change in the trend. In September, the demand for baby chicks for commercial broiler production has exceeded the supply and is expected to do so for several months, until supplies of hatching eggs can be increased. These same influences may be expected to bring similar results, although more slowly, in both cattle and dairy feeding, as well as in hog farrowings for next spring's pig crop.

Thus the record grain crops provide the means for increasing meat production. The current acute shortage is in part the sequence of the summer excesses, in part the result of restoring ceilings at prices demonstrated to be arbitrarily low. As the season goes on cattle will come off the ranges, and in another month or two the spring pig crop will reach marketing weights. Beyond that, the bumper crops can be expected to lead to more meat, dairy and poultry products next year. But the whole livestock industry, from the breeder to the consumer, is under the shadow of arbitrary prices, subject to arbitrary change. The real question now is whether the coming increase in supplies will flow through normal channels, or whether black markets will continue prevalent and distribution disrupted.

"Full Employment" — 1946 Model

For the past several years the American people have been haunted by the spectre of a grave unemployment crisis following the war. Notwithstanding the experience after World War I, when similar fears proved groundless as business and employment went into a boom and inflation, instead of a tailspin, predictions of deflation have been rife. The following quotations cited in a Brookings Institution report in 1943 — "Postwar Re-employment: The Magnitude of the Problem", by Karl T. Schlotterbeck — are typical of what many people were saying:

> Thirty million Americans in the armed services or munitions industries (will have) to be transferred from the occupations of war to those of peace . . . Some very careful planning is in order if 30 million citizens are to be transferred from war to peace without disaster.[1]
>
> If over 29 millions . . . are to be turned suddenly into the labor pool, and if private industry is unable to absorb them quickly, our whole economic system will go into a downward spiral.[2]
>
> Of the 11 million men in the armed forces, approximately 9 million will be discharged and will be hunting for positions in private employment. To these 9 million must be added the major part of the 20 million workers in the war plants most of whom will be laid off overnight. They, together with the returning soldiers, will make a temporary unemployed army of between 20 and 25 millions.[3]
>
> We are going to develop very quickly a large volume of unemployment in the United States unless we can have ready a large scale program of public works, non-construction as well as construction, to throw into immediate operation.[4]

[1]Stuart Chase, "Man Is a Working Animal," *Survey Graphic*, May 1943, p. 155.

[2]Homer Hoyt, "The Structure of American Cities in the Post-War Era," *American Journal of Sociology*, Jan. 1943, pp. 478-9.

[3]Address of Senator Millard E. Tydings before the Indiana State Bar Association, July 17, 1943.

[4]John H. G. Pierson, Chief, Post-War Division, U. S. Bureau of Labor Statistics, in pamphlet *Employment After the War*, written at request of American Federation of Labor, 1943, p. 3.

The pessimism reflected in such statements died hard. Our readers will recall the flood of gloomy predictions by labor leaders, government officials, and others that greeted VJ-day in August a year ago. Estimates of unemployment ranging as high as 8 million were generally accepted in government circles, with the late Sidney Hillman, then chairman of the C.I.O. Political Action Committee, quoted in the press as predicting 10 million out of work "within the next six to eight weeks," and as demanding more government relief and support.

In September 1945 former Secretary of Commerce Wallace published his book, "Sixty Million Jobs," calling for an elaborate program of government planning and spending in order to attain the goal of "full employment" by 1950. During the winter of 1945-46 determined groups were trying to drive through Congress a bill to commit the Government to large scale spending to maintain employment. Throughout most of this period, government officials, though manifesting concern over rising symptoms of inflation, were still talking of measures to sustain "purchasing power". Despite the rapidly changing situation, much public thinking and policy making continued to reflect the persistent undercurrent of doubt and defeatism born of the depressed '30s.

"Full Employment" Arrives

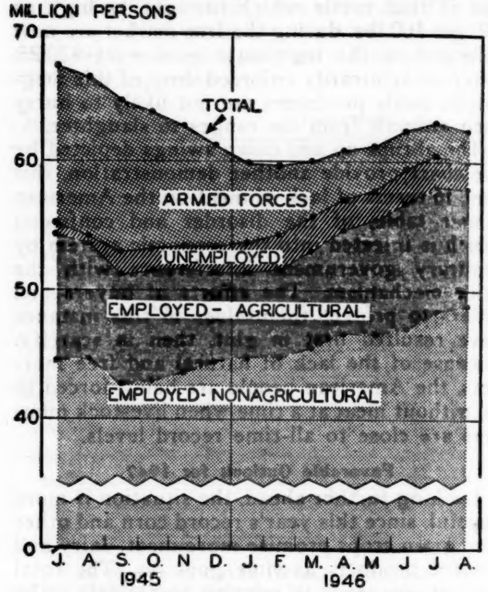
Meantime, while many people were worrying about unemployment and deflation, business was forging ahead with the reconversion job. For many industries, this entailed little or no change in plant and equipment or dislocation of labor; even in industries engaged in more specialized types of war production, physical reconversion has gone forward more smoothly than generally anticipated, thanks largely to the foresight and skillful planning of management.

With a huge vacuum of unsatisfied demands, and with high levels of current incomes and reserves of buying power in the hands of the public, civilian production has rapidly expanded. Today, despite cancellation of war orders and veteran demobilization, the country is experiencing — not the 8 to 10 million jobless so widely predicted a year ago — but an acute labor shortage which is seriously hampering the ability of industry to expand output further and supply the goods so urgently wanted by everyone.

The following chart, based on U. S. Census Bureau estimates, shows what has been happening to employment over the past year.

In July a year ago, with the war emergency calling for the services of every available person, the aggregate labor force was estimated at 67.5 million, probably an all-time high. Of this, 12.3 million were in the armed services, 54.3 million in civilian employment, and less than one million classified as unemployed.

Following VJ-day, both the aggregate amount and distribution of the labor force underwent major changes. On one hand, the



Changes in Distribution of the Estimated Total Labor Force During the Past Year.

number of available workers was augmented by discharge of nearly 10 million veterans, the shifting about of war workers looking for new jobs, and an increment of half a million new workers due to population growth.

Against these increases, on the other hand, have been, first, the withdrawal from the total labor force of some 4 to 5 million — mainly women, older persons past normal retirement age, and very young people — who were in the labor market only for the war emergency; and, second, the rapid expansion in peacetime production which has carried civilian employment to an estimated all-time high around 58 million, some 4.4 million higher than in August last year.

Reflecting this taking up of slack, the unemployment estimate even at the March postwar peak totalled only 2,710,000, and in August was down to about 2 million. This is within the range of most estimates for "frictional" unemployment (seasonal unemployment, people changing from job to job, etc.) in good times, and coincides with a total of civilian employment plus the armed forces of approximately 60 million. Moreover, even these figures on unemployment raise some doubt as to their meaning and whether they are people who are really unable to get work.

In other words, the goal of "full employment", as the term is generally defined, was reached almost while the "full employment planners" were still talking about it as a distant objective, attainable possibly only with the help of large scale government spending.

Problems of Full Employment

Now that we have substantially full employment, it is instructive to review frankly some of the complications that go with it. From much of the literature on "full employment", one might get the impression that it is no problem at all to guarantee jobs for everyone through government spending or other action; and that it is perfectly possible to manage a perpetual prosperity despite the vast complexities of the economic system, the frailties of human nature and the tendency to go to extremes. Certainly the idea of a good job for everyone who wants to work is appealing; the only question is the practical one of how to go about realizing it, and what the collateral effects will be.

One of the basic problems of a full employment policy, that has stood out in our present inflationary situation, is reconciling such a policy with price stability. We have seen how, as business has expanded and drawn on available reserves of manpower and materials, bottlenecks have appeared that opened the way for strongly entrenched groups to demand higher prices for their goods and services. The result has been an inflationary wage-price spiral which has become more and more difficult to control as supplies of labor and materials have tightened.

Mr. Henry Wallace, in "Sixty Million Jobs" (p. 25), speaks scornfully of those who foresee inflationary dangers of this kind, referring to those who "pay sly lip service to full employment — but actually, they would tolerate several million permanently unemployed in the unsound belief that the competition of the unemployed will keep wages down and profits up."

The problem, however, is not so easily dismissed. It is one thing to assert that labor ought not be subject to excessive competition of large numbers of unemployed, and another thing to assert that it ought be relieved of all competition within its own ranks by some form of full employment guarantee. The fact is — Mr. Wallace to the contrary notwithstanding — that, human nature being what it is, a little competition is a good thing for everyone, business and labor alike. The experience with both wages and prices in the past few years is ample evidence of what happens when the bidding for manpower and materials gets too one-sided.

Lest this be considered reactionary heresy, it may be noted that some other leading full employment theorists are candid in recognizing the inflationary pressure of such policies upon wages. Prof. Jewkes, of the University of Manchester, England, one of the authors of the British White Paper committing the British Government to the full employment principle, states frankly that "most of the problems of maintenance of employment . . . arise from the fact that the policy of full employment involves the danger of inflation"; that, "if a policy of full employment ever drifts into the frustration of inflation my guess would be that the immediate cause will be intemperate wage increases."[1]

According to Sir William Beveridge, noted British economist who, with the late Lord Keynes, has done more than anyone else to spread the full employment gospel, "there is no inherent mechanism in our present system, which can with certainty prevent competitive sectional bargaining for wages from setting up a vicious spiral of rising prices under full employment."[2] As a solution, Sir William would rely heavily upon wisdom and restraint on the part of labor in formulating and pressing its demands, and voluntary arbitration — safeguards which, it is suspected, will to many seem frail indeed when stacked up against temptations afforded under a full employment program.

Worker Morale and Productivity

Another problem, brought out during the current period of full employment, is that plenty of jobs and high wages have not been accompanied by a high level of worker morale and productivity, but rather the reverse. Notwithstanding that most concerns now have more people on their payrolls than ever before in peacetime, the widespread testimony of employers is that output per worker has been well below prewar.

The explanation, of course, is not simple. Some of it is due to shortages of raw materials and parts, which interfere with production schedules. Some of it reflects frictions in getting reorganized for peacetime business training of new working forces, etc. But the reasons evidently go much deeper than this, and have to do with the attitude that people have towards their jobs and the necessity of doing a good day's work. Strikes — often for trivial causes, and frequently in defiance of union leadership — absenteeism, and high rates of labor turnover are taking a heavy toll of efficiency and production. They contrast strangely with the serene picture so often

---

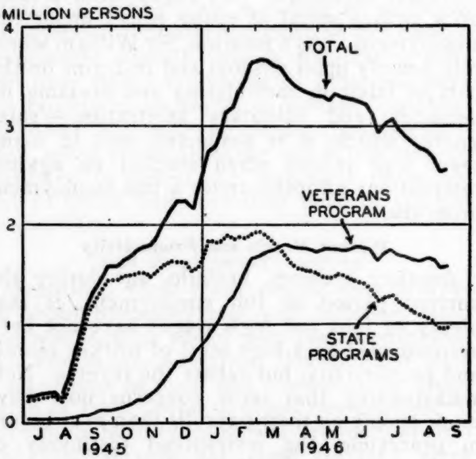
[1] Address entitled "Second Thoughts on the British White Paper on Employment Policy" before National Bureau of Economic Research, New York, June 1946.

[2] "Full Employment in a Free Society", by William H. Beveridge, W. W. Norton & Co., N. Y. 1945, p. 199.

painted of the conditions to be expected under full employment. Restlessness among veterans has been particularly high, with the "quit rate" for service men employed in the manufacturing industries reported as running 50 per cent above that for non-service employes.

How much these conditions reflect a psychological reaction and letdown following the war, which will pass in time, and how much a condition inherent in "full employment" (in common everyday parlance, "business boom") is hard to say. The question is one that full employment policy advocates might well ponder.

One of the signs of the times has been the number of persons applying for and receiving unemployment compensation. This is indicated by the next chart covering the State unemployment system and the veterans' unemployment allowances.



Number of Persons Receiving Unemployment Benefits.

It will be seen that through most of the Spring and Summer unemployment claims were being paid to well over 3 million persons. At the end of August there were still on the rolls around 2½ million, consisting of approximately 1½ million veterans and one million non-veterans. The fact that these figures on persons drawing unemployment compensation run consistently above the Census Bureau totals of the unemployed is mainly because people still on a payroll, but temporarily idle, may draw compensation.

While the number of these compensation claims may not be considered large in view of the scope of demobilization and reconversion, it is nevertheless large relative to the urgent demand for labor in most localities. Here, again, the explanations vary — workers without jobs may not be qualified for jobs that are open, jobs and applicant localities may not match and the housing shortage has been a handicap in bringing both together, jobs may not measure up to hoped-for pay or working conditions. Many veterans have wanted to take a little time to "look around" before settling down.

With all due allowances, however, it remains true that too many people have been content to sit back and live off the Government rather than take jobs that are offered and hold on to them. Almost everyone knows of some instances of abuses. General Bradley, Administrator of Veterans Affairs, has referred publicly to the minority of veterans who are not really seeking work. The Veterans Administration has expressed concern over the number of veterans who are repeaters on the compensation rolls, claims filed by repeaters in July accounting for 43 per cent of all new claims for the month. Unemployment compensation to non-veterans also shows a high rate of repeaters. This is government planning in reverse. The Government had planned liberal compensation benefits to tide over slack employment and deflation, but people are taking advantage of it.

"The Carrot and the Stick"

All this suggests that there is such a thing as making it too easy for people. "The human donkey," as the London Economist asserts in an editorial in its issue of June 29, last, that may well become a classic, "requires either a carrot in front or a stick behind to goad it into activity." While the Economist is directing its remarks to the British scene, much of what is says is so apt to this discussion that we quote as follows:

> It is fashionable at the moment to argue that the carrot is the more important of the two: "incentive" is the watchword, and all classes of the community are busy arguing that if only they are given a little bit more in the way of incentive (at the expense of the rest of the community) they will respond with more activity. From miners to company promotors, the basic argument is the same . . . It may be true that one reason why people will not work hard is that they can buy so little with their wages. But it is much more true that they will not work because the fear of the sack has vanished from the land and because the Bankruptcy Court is a depressed area . . . If an active and progressive economy is to be founded on the frailties of human nature, both (the carrot and the stick) are needed.
>
> But the whole drift of British society for two generations past has been to whittle away both at the carrot and the stick, until now very little of either is left . . . Commercial success itself has been turned, in the eyes of wide circles of society, into a positive disgrace. There is a conspiracy of labour, capital and the state to deny enterprise its reward. The state takes it away in high taxation . . . The trade unions . . . will permit labour-saving devices only provided that they do not in fact save labour. Nor is the attitude of organized capital any better . . . The industrialist who discovers a way of making better things more cheaply (which is what he is sent on earth to do) is deprived

by the state of all pecuniary return and by his own colleagues of any social reward. Instead of a carrot he gets a raspberry . . .

The same process has been applied to the wage-earner as well. Together with the levelling down of incomes there has gone a levelling up of wages. Day rates and "guaranteed weeks" steadily replace payment by results, with the deliberate intention of ensuring that the slacker shall earn as much as the hard worker. The margin of advantage that a skilled artisan secures over an unskilled labourer . . . is only a small fraction of what it was before the First German War . . . The whole effect of the growth in strength of the trade union movement — indeed, one can say its deliberate intention — has been to divorce the worker's income (or at least his cash income) from any dependence on the efforts he makes.

The stick has been whittled away no less than the carrot . . . When full employment is added to social security, the sanction for slackness almost disappears; the worker knows that he is unlikely to lose his job and that his sufferings will be limited if he does. Moreover, there are already signs that the admirable principle of full employment is likely to be translated in practice into fixed employment, the doctrine that nobody must ever be thrown out of work.

The question, indeed, is — as the Economist puts it — "How can the carrot and the stick be combined with a pleasant life for the donkey?"

Full Employment and Fiscal Policy

Still another way in which full employment theory has not worked out "according to Hoyle" has been in the area of fiscal policy. As our readers are aware, the Government, according to the theory, is supposed to forecast the economic weather ahead and take steps to "compensate" for expected swings in private spending by increasing "purchasing power" through public works and deficit financing in times of depression, and by siphoning off purchasing power through a shift to budgetary surpluses and debt retirement in times of boom.

This country has not accepted the "compensatory budget" principle, one of the dangers of which was illustrated by the mistaken government predictions of widespread unemployment immediately following VJ-day. This obsession as to deflation was an influence in shaping official policies, and had the effect of greatly aggravating the inflation that actually ensued. Had the Government, in addition, been committed to a compensatory program of public works and other spendings to ward off the expected depression, there is no telling how much more serious the inflationary development might have been.

Moreover, after it became generally admitted that inflation and not deflation was the problem to be dealt with, the Government was unable to reverse and apply the universally recognized remedy of a budget surplus. (Debt reduction this year has been wholly the result of application of excess cash built up from previous borrowings.) The trouble is that it is so much easier to increase expenditures than to cut them down. Only within the past month the Administration has acknowledged that it can no longer expect to carry out its plan announced last July to cut spending on public works by $700 million for the current fiscal year. The cut, which had been proposed in the interest of conserving building materials and labor, as well as economy, was abandoned, apparently under pressure of protests from government agencies and from the localities affected.

The theory, in other words, that government spending can be turned on and off at will, like an electric switch, simply doesn't work.

Government Planning — Theory and Practice

In recent months we have thus had some test of the theory of full employment and of government planning and attempts to control the working of economic laws, and it is fair to say that we have chalked up several notable failures of planning to do what has been claimed:

1. The full employment we now have was neither planned nor even foreseen by the Government.

2. Unemployment insurance is being drawn on heavily at a time when the trouble is not lack of work but lack of workers.

3. At a time of inflation the Government has adopted inflationary policies with respect to wages and certain types of spending because it misjudged the nature of the situation.

4. The OPA price-fixing, instead of making for a smooth running economic machine, has stalled it at many points.

The question is whether this is just the bad management that goes along with early experiences in government planning, or whether it shows the real limitations on government action, due to the element of human psychology and the fact that political pressures constantly conflict with the economic requirements. At any rate, it ought to give pause to the consideration of new proposals to have the Government deal with additional areas of the country's economic life.

THE NATIONAL CITY BANK OF NEW YORK

***Head Office:* 55 Wall Street, New York**

Condensed Statement of Condition as of September 30, 1946

Including Domestic and Foreign Branches

ASSETS

Cash and Due from Banks and Bankers		$1,180,300,277.09
United States Government Obligations (Direct or Fully Guaranteed)		2,494,668,999.85
Obligations of Other Federal Agencies		39,669,206.31
State and Municipal Securities		203,342,412.51
Other Securities		102,372,971.86
Loans, Discounts, and Bankers' Acceptances		953,063,063.17
Real Estate Loans and Securities		3,407,291.95
Customers' Liability for Acceptances		10,083,061.78
Stock in Federal Reserve Bank		6,600,000.00
Ownership of International Banking Corporation		7,000,000.00
Bank Premises		29,467,578.34
Other Assets		5,075,410.46
Total		$5,035,050,273.32

LIABILITIES

Deposits		$4,723,043,624.46
(Includes U. S. War Loan Deposit $332,238,496.69)		
Liability on Acceptances and Bills	$ 15,099,747.42	
Less: Own Acceptances in Portfolio	3,415,969.73	11,683,777.69
Items in Transit with Branches		4,224,487.76
Reserves for:		
Unearned Discount and Other Unearned Income		3,562,685.96
Interest, Taxes, Other Accrued Expenses, etc.		31,812,607.18
Dividend		2,325,000.00
Capital	$ 77,500,000.00	
Surplus	142,500,000.00	
Undivided Profits	38,398,090.27	258,398,090.27
Total		$5,035,050,273.32

Figures of Foreign Branches are included as of September 25, 1946 except those of the Dairen Branch which are prior to the outbreak of the war, but less reserves.

$604,653,620.46 of United States Government Obligations and $4,844,020.33 of other assets are deposited to secure $519,932,392.72 of Public and Trust Deposits and for other purposes required or permitted by law.

(Member Federal Deposit Corporation)

DIRECTORS

GORDON S. RENTSCHLER
Chairman of the Board
W. RANDOLPH BURGESS
Vice-Chairman of the Board
WM. GAGE BRADY, JR.
President

SOSTHENES BEHN
President, International Telephone and Telegraph Corporation
CURTIS E. CALDER
Chairman of the Board, Electric Bond and Share Company
GUY CARY
Shearman & Sterling & Wright
EDWARD A. DEEDS
Chairman of the Board, The National Cash Register Company
CLEVELAND E. DODGE
Vice-President, Phelps Dodge Corporation
A. P. GIANNINI
Founder-Chairman, Bank of America National Trust and Savings Association
JOSEPH P. GRACE, JR.
President, W. R. Grace & Co.
JAMES R. HOBBINS
President, Anaconda Copper Mining Company
AMORY HOUGHTON
Chairman of the Board, Corning Glass Works
GERRISH H. MILLIKEN
President, Deering, Milliken & Co. Incorporated
GERARD SWOPE
Honorary President, General Electric Company
REGINALD B. TAYLOR
Williamsville, New York
ROBERT WINTHROP
Robert Winthrop & Co.

CITY BANK FARMERS TRUST COMPANY

***Head Office:* 22 William Street, New York**

Condensed Statement of Condition as of September 30, 1946

ASSETS

Cash and Due from Banks		$ 27,973,922.78
United States Government Obligations (Direct or Fully Guaranteed)		125,457,854.55
Obligations of Other Federal Agencies		1,074,404.21
Loans and Advances		663,388.22
Real Estate Loans and Securities		2,145,794.47
Stock in Federal Reserve Bank		600,000.00
Bank Premises		3,261,644.25
Other Real Estate		114,770.35
Other Assets		2,212,240.40
Total		$163,504,019.23

LIABILITIES

Deposits		$130,699,454.10
(Includes U. S. War Loan Deposit $22,606,767.00)		
Reserves		4,636,911.19
Capital	$10,000,000.00	
Surplus	10,000,000.00	
Undivided Profits	8,167,653.94	28,167,653.94
Total		$163,504,019.23

$27,746,774.14 of United States Government Obligations are deposited to secure the United States War Loan Deposit and for other purposes required or permitted by law.

(Member Federal Deposit Insurance Corporation)

DIRECTORS

GORDON S. RENTSCHLER
Chairman of the Board
LINDSAY BRADFORD
President

GILBERT G. BROWNE
22 William Street
W. RANDOLPH BURGESS
Vice-Chairman of the Board, The National City Bank of New York
J. HERBERT CASE
22 William Street
EDWARD C. DELAFIELD
Delafield & Delafield
CLEVELAND E. DODGE
Vice-President, Phelps Dodge Corporation
ROBERT W. DOWLING
President, City Investing Company
SAMUEL SLOAN DURYEE
Spence, Hotchkiss, Parker & Duryee
A. P. GIANNINI
Founder-Chairman, Bank of America National Trust and Savings Association
DOUGLAS GIBBONS
Douglas Gibbons & Co., Inc.
ROBERT L. HOGUET
Amend & Amend
CHARLES C. PARLIN
Shearman & Sterling & Wright
GEORGE W. PERKINS
Executive Vice-President, Merck & Co., Inc.
HENRY C. TAYLOR
Taylor, Pinkham & Co., Inc.
REGINALD B. TAYLOR
Williamsville, New York
EARLE S. THOMPSON
President, American Water Works and Electric Company, Incorporated
ROBERT WINTHROP
Robert Winthrop & Co.
WALTER REID WOLF
Senior Vice-President
BOYKIN C. WRIGHT
Shearman & Sterling & Wright